

SUMMARY ANALYSIS OF AMENDED BILL

Author: Runner & Ackerman Analyst: John Pavalasky Bill Number: SB 1584
 Related Bills: See Prior Analysis Telephone: 845-4335 Amended Date: March 27, 2006
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Health Savings Account (HSA) Deduction Conformity Retroactive to Tax Year 2004

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended _____.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED
February 23, 2006, STILL APPLIES.

☒ OTHER – See comments below.

SUMMARY

This bill would retroactively conform California personal income tax law on HSA contributions to federal law.

SUMMARY OF AMENDMENTS

The March 27, 2006, amendments make HSA deduction conformity retroactive to taxable year 2004, allow amended returns to be filed to claim the deduction, and make legislative findings stating the public purpose of the bill.

A new discussion under the headings EFFECTIVE/OPERATIVE DATE, THIS BILL, FISCAL IMPACT, and ARGUMENTS/POLICY CONCERNS is provided. The March 27, 2006, amendments also impact revenue and a new revenue estimate is provided. The remainder of the previous analysis of the bill as introduced February 23, 2006, still applies.

Board Position:

_____ S _____ NA _____ NP
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Legislative Director

Date

Brian Putler

4/7/06

EFFECTIVE/OPERATIVE DATE

This bill would be effective immediately and retroactively operative for taxable years beginning on or after January 1, 2004. This bill would also specifically allow otherwise barred amended returns to be filed relating to the retroactive conformity to the HSA provisions made by this bill for a two-year period beginning with the effective date of the bill.

POSITION

Pending.

ANALYSIS

THIS BILL

This bill would conform California law to the federal HSA provisions retroactively to the 2004 taxable year as follows:

1. Allows the same above-the-line deduction of contributions to an HSA by or on behalf of an individual and adopts the rules applicable to the trust itself in order for the trust to be exempt from tax starting with tax year 2004. Consistent with general conformity policy in other areas, the federal 6% excise tax on excess contributions and the federal estate tax provisions are not being conformed to by this bill.
2. Allows the same exclusion from an employee's gross income for the amount of any contributions to an HSA (including salary reduction contributions made through a cafeteria plan) made on the employee's behalf by their employer starting with tax year 2004.
3. Allows rollovers from MSAs to be made to HSAs as well as rollovers between HSAs without penalty starting with tax year 2004.
4. Adopts the same \$50 penalty for failure to make required reports starting with tax year 2006.

In addition, this bill would allow otherwise barred amended returns for tax years 2004 and 2005 to be filed in order to claim a refund with respect to HSAs for amounts previously included in income, deductions not previously allowed, rollovers previously not treated as eligible rollovers, and previously assessed penalties.

FISCAL IMPACT

This bill would require the department to process an unknown number of amended returns as claims for refund. Although the number of amended returns is unknown, department staff estimates that the cost associated with processing these amended returns would be insignificant.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses.

Estimated Revenue Impact of SB 1584 Enactment Assumed After 6/30/06 Effective with Taxable Years Beginning On or After 1/1/04 [\$ In Millions]			
2005-06	2006-07	2007-08	2008-09
-\$4	-\$9	-\$15	-\$20

Previous estimates for this provision in the Governor's proposed budget were revenue losses of \$3, \$8, \$15, and \$20 (in millions) for 2005-06, 2006-07, 2007-08, and 2008-09, respectively. Previous estimates were based on preliminary California tax return data for timely filed 2004 returns and extrapolated to include returns yet to be filed. Current estimates are based on complete 2004 California tax return data. This estimate is the same as the revenue estimate provided for SB 1787 (Ackerman, 2005/2006) as introduced February 24, 2006, that is the same as this bill.

Revenue Discussion

The revenue impact of the bill would be determined by: 1) the amount of contributions to health savings accounts deducted on tax returns, 2) the amount of contributions to health savings accounts made on behalf of employees (including salary reduction contributions), and 3) the amount of balances in Archer medical savings accounts rolled over to health savings accounts, multiplied by marginal tax rates of taxpayers deducting or excluding such contributions.

Estimates are based on complete tax return data for the 2004 taxable year. Complete return data indicates roughly 7,500 returns reflected HSA adjustments on Schedule CA totaling \$20 million. This means that these taxpayers made tax-deductible contributions for federal purposes that were reversed for state purposes. At this time, it is not known how many additional taxpayers may have made contributions and neglected to make the Schedule CA adjustment. Also, contributions made on an employee's behalf by an employer (including salary reduction contributions made through a cafeteria plan) cannot be identified on a tax return. Therefore, it is not known how many additional HSAs may exist as a result of this contribution arrangement.

National data would suggest that California's proportion of total dollar contributions to these accounts should be greater than the return data reflects. It is believed that California residents have extensive HMO coverage and, therefore, total dollar contributions to HSAs are less than otherwise expected.

National data for HSAs indicates substantial growth in the number of accounts nationwide during 2005, exceeding 200%. Estimates above reflect such a growth rate through 2007 and are decreased thereafter to more sustainable rates.

For 2004, contributions totaling \$20 million were made to HSAs by California taxpayers. For 2005, it is estimated that contributions totaled nearly \$45 million. Applying a marginal tax rate of 7% results in a revenue loss of \$1 million for 2004 (\$20 million x 7%) and \$3 million for 2005 (\$45 million x 7%). Tax year estimates are converted to cash flow fiscal year revenue estimates reflected in the table. Estimates for 2004 and 2005 taxable years are accrued back to the 2005-06 fiscal year (\$1 million loss for 2004 + \$3 million loss for 2005 = \$4 million loss).

ARGUMENTS/POLICY CONCERNS

By making the state's conformity to the federal HSA provisions retroactive to the inception of the federal law, this bill would reverse the additional taxes and penalties taxpayers were required to pay for tax years 2004 and 2005 as well as simplify the preparation of California tax returns for current and future years to which the provisions apply. For example, the personal income tax return under current state law begins with federal adjusted gross income (AGI) after taking into account the federal HSA provisions and adjustments are required to be made for each HSA difference between California and federal law in order to arrive at state AGI. The following adjustments are currently required:

- Increase AGI by the amount of the federal HSA deduction.
- Increase AGI by the amount of any interest earned on the account excluded on the federal personal income tax return.
- Increase AGI by the amount of any contribution to an HSA, including salary reduction contributions made through a cafeteria plan, made on the employee's behalf by their employer that is excluded on the employee's federal personal income tax return.
- Increase AGI by the amount of any distribution from an MSA that is rolled into an HSA that is excluded on the taxpayer's federal personal income tax return. Additionally, under California law, that MSA distribution is not treated as being made for qualified medical expenses and is, therefore, subject to the MSA 10% penalty tax.

Because the amounts contributed during any taxable year are not deductible for state purposes and the earnings in the account, contributions by an employer on the employee's behalf, or rollover from an MSA are taxable by California, the taxpayer will have a tax basis in the account for state but not federal purposes. Over the long-term existence of an HSA, distributions that would otherwise be included in the taxpayer's federal AGI for future taxable years would need to be adjusted to account for this California basis. This would lead to the same types of recordkeeping issues that currently require taxpayers to account for the recovery of California basis in IRAs for the taxable years before California conformed to the federal deductible amount.

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